

EXECUTIVE SUMMARY

A STUDY OF THE IMPACT OF RAISING THE MINIMUM WAGE IN SOUTH DAKOTA: 2007 UPDATE

**By
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This study has examined the impact of raising the minimum wage rate in South Dakota to follow the anticipated increase in the Federal minimum wage rate currently in Congress. This minimum wage bill would increase the wage from the current minimum wage of \$5.15 per hour to \$7.25 per hour in three seventy cent increments. The first increase would be to \$5.85 per hour within 60 days of the enactment of the bill (2007), to \$6.55 per hour one year later (2008), and to \$7.25 per hour one year later (2009).

Based on standard economic theory, the analysis determined the impact in terms of the benefits and costs of an increase in the minimum wage rate. The benefits of an increase in the minimum wage are experienced by low-wage workers who realize an increase in wages. Employers who must pay higher wages realize a loss. The gains and losses at this point are offsetting. However, this does not take into account job losses.

Economic theory indicates that as the minimum wage rate is increased some workers will lose their jobs. The higher the minimum wage rate the greater the job loss. Using a consensus elasticity estimate of -0.2, where a 10 percent increase in the minimum wage will reduce employment by 2 percent, we estimated the “disemployment” impact of an increase in the minimum wage rate. The analysis indicates a job loss of 11 workers if the minimum wage rate is raised to \$5.85 per hour in 2007. If the minimum wage rate is increased to \$6.55 per hour in 2008 the job loss is estimated to be 130 workers. If the minimum wage rate is raised to \$7.25 per hour in 2009 the job loss is estimated at 375 workers. These job losses represent a loss to both the workers who now do not have a jobs and to the employers who would have profitably employed these out-of-work workers. These losses represent a net loss to society because they represent losses for which there is no offsetting gain. Fewer people are employed and contributing to the economy than before the minimum wage increase.

As shown in the Table below, the job losses depend on the level of the minimum wage rate and range from 11 to 375 jobs lost as the minimum wage is phased in overtime. The benefits to the low-wage workers who realize a pay raise range from \$0.523 million for a minimum wage increase from \$5.15 per hour to \$5.85 per hour to \$20.7 million for an increase to \$7.25 per hour. The lost wages for the low-wage workers who lose their

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jobs range from \$0.1 million to \$4.25 million. The employer losses range from \$0.525 million to \$21.0 million. The employer losses exceed the low-wage worker gains because the employer loss includes the higher wages paid to employed workers plus the lost profits from employing fewer workers. Finally, the net loss, or what economists call deadweight loss, ranges from \$0.1 million for the minimum wage increase to \$5.85 per hour to \$4.5 million for a minimum wage increase to \$7.25 per hour. This net loss occurs because of the disemployment effects of the minimum wage increase. As further indicated, the loss is about \$1.20 per dollar gained. What this indicates is that increases in the minimum wage are an inefficient way of assisting low-wage workers.

	Increasing the Minimum Wage from \$5.15 to		
	\$5.85 in 2007	\$6.55 in 2008	\$7.25 in 2009
Effect			
Disemployment	11	130	375
Number of Workers who directly experience an Increase in wages	3,614	12,584	19,871
Increase in Earnings of Employed Low Wage Workers	\$523,145	\$6,843,309	\$20,762,078
Lost Earnings by Disemployed	\$105,393	\$1,389,335	\$4,253,068
Total Change in Earnings of Low Wage Workers	\$417,752	\$5,453,974	\$16,509,009
Losses to Employers	\$525,056	\$6,894,992	\$21,013,710
Net Loss (Deadweight Loss)	\$107,304	\$1,441,018	\$4,504,701
Loss per Dollar Gained	1.21	1.21	1.22

So what are we to conclude from this analysis? We will try to answer this question by posing a series of questions and our answers based on our study.

Question: Does an increase in the minimum wage benefit low-wage workers?

Answer: Yes. It raises the income for many low-wage workers. We estimate that the increase in the minimum wage from \$5.15 to \$5.85 per hour would increase wages for 3,614 workers. The increase in the minimum wage to \$6.55 per would increase wages for 12,584 workers and the increase to \$7.25 per hour would increase wages for 19,871 workers.

Question: Do some employers lose as result of the minimum wage increase?

Answer: Yes. Those employers lose who have to pay higher wages to the workers who retain their jobs. The gains to workers who retain there jobs are

fully offset by the losses suffered by the employers. At this point, there is no change in societal welfare unless we weigh the dollar gains to workers differently than the dollar losses to the employers.

Question: Do some workers lose as a result of an increase in the minimum wage? **Answer:** Yes. The workers who find themselves without a job are worse off. Our estimates indicate that at a minimum wage of \$5.85 per hour 11 jobs will be lost. At \$6.55 the loss of jobs is estimated at 130 and at \$7.25 per hour the job loss is estimated to be 375. This is a loss for which there are no offsetting gains and therefore a net loss to society.

Question: Do some employers lose as a result of employing fewer workers than before the increase?

Answer: Yes. Those employers employing fewer workers lose some profits due to the higher wage. We have to remember that employers hire workers because they provide greater value to their employer than their cost. If the wage paid to a worker is higher without a corresponding increase in productivity, the profit to the employer is lower.

Question: Overall, are workers better off as a result of the minimum wage increase?

Answer: Yes. The gains in income from the workers who retain their jobs are greater than the losses suffered by workers who lost their jobs. We estimate that at \$7.25 per hour 19,871 workers gain while 375 workers lose their jobs. Because of the inelastic nature of the demand for labor, the total gains to the workers who maintain their job at the higher wage is greater than the losses suffered by those workers who lose their jobs. The gains received by those workers who get a pay raise is \$20.7 million compared to the losses of those workers who lose their jobs of \$4.3 million

Question: Overall, are employers worse off as a result of the minimum wage increase?

Answer: Yes. They must pay higher wages than before and lose the profits they would have earned on the marginal workers who are now disemployed. The loss suffered by the employers is \$21.0 million.

Question: Is society better off as a result of a higher minimum wage?

Answer: No. Society is worse off if the well-being of society is measured by society's income. Increasing the minimum wage reduces total societal income as a result of the job losses suffered by some workers and the lost profits to employers who would have profitably employed them.

Question: So given the costs and benefits is raising the minimum wage a good or bad policy?

Answer: Like all policy issues it is a matter of trade-offs. There are benefits and there are costs. Different people may evaluate the costs and benefits differently.

If a dollar gained by a low wage worker is valued more highly by the policy maker than is a dollar lost by the employer and the unemployed, then the increase in the minimum wage could raise societal welfare.

To illustrate, our estimates indicate that every dollar gained by someone costs someone else \$1.20. If the policy maker believes the \$1.00 to the gainer means more than the \$1.20 means to those who lose, then raising the minimum wage is a good policy. In less precise language the argument may be stated, "So a few people lose their jobs and employers have to pay higher wages, the gains to the large number of low-wage workers is worth the cost."

Alternatively, if the policy maker is unwilling to assert that one dollar "means" more to one group than to another, then there is a societal welfare loss associated with an increase in the minimum wage.